Decision 06-06-038 June 15, 2006

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U 338-E) for Authority to Recover Capital Additions to its Fossil Generating Facilities Made Between January 1, 1997 and March 31, 1998 or the Date of Divestiture for Those Generating Facilities Divested by July 8, 1998 and Related Substantive and Procedural Relief.	Application 99-04-024 (Filed April 19, 1999)

ORDER GRANTING LIMITED REHEARING OF DECISION (D.) 04-02-025 AS TO CERTAIN CAPITAL ADDITIONS PROJECTS, AND DENYING REHEARING IN ALL OTHER RESPECTS

I. SUMMARY

The challenged Commission Decision, D.04-02-025, approved capital additions for Southern California Edison Company ("SCE") totaling $52,216,000. Of this total, we approved $31,782,000 for costs related to capital additions for environmental, regulatory, and safety purposes and for Federal Energy Regulatory Commission ("FERC") relicensing purposes. We found that these costs had already been recovered by SCE in customer bills. The Decision also approved capital additions costs of $20,434,000 for divested non-nuclear generation plant between 1997 and July 8, 1998, to maintain plant through December 2001. We determined that these costs had also been previously recovered or amortized by SCE. Finally, the Decision authorized SCE to recover in future rates the return on rate base and taxes on the capital additions considered in this proceeding, which are recorded in the Non-Nuclear Generation-Related Capital Additions

Memorandum Account ("NGCAMA"). The return on rate base and taxes on the capital additions at issue in the proceeding amount to approximately $1.5 million.

We have determined that limited rehearing should be granted as to certain issues identified below, and that SCE should be permitted to continue to recover in rates all amounts authorized for recovery in D.04-02-025 that are not yet fully recovered, subject to adjustment and/or refund, while the rehearing process is pending.

II. BACKGROUND

In D.97-09-048, the Commission established the approach for evaluating the appropriateness of the utilities' recovery of capital additions made to non-nuclear generating plant (hereinafter referred to as "capital additions") to determine compliance with Public Utilities Code section 367[1] during the transition period. (*Re Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation* ("*Capital Additions Decision*") [D.97-09-048] (1997) 75 Cal.P.U.C.2d 434.) For capital additions made during 1996-97, the period before the Power Exchange ("PX") and the Independent System Operator ("ISO") were scheduled to begin operations, the Commission provided for recovery based on an after-the-fact reasonableness review of recorded expenditures. The after-the-fact reasonableness review was subsequently extended to capital expenditures incurred in 1998 prior to the opening of the ISO and the PX on April 1, 1998. (See *Re Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation* ("*Interim Opinion Modifying Decision 97-09-048 Regarding Review of Capital Additions*") [D.98-03-054] (1998) 79 Cal.P.U.C.2d 6.) The after-the-fact reasonableness review mechanism allowed the utility to make timely business decisions without prior resolution of ratemaking treatment. A market control approach was adopted

[1] Unless otherwise noted, all statutory references are to the Public Utilities Code.

in D.97-09-048 for recovery of capital additions made during the rest of the transition period.

SCE filed its application for recovery of the capital additions costs on April 19, 1999. The Utility Reform Network ("TURN") and the Office of Ratepayer Advocates ("ORA") filed protests. A prehearing conference was held on July 1, 1999, and the parties then submitted testimony, rebuttal testimony, and revisions to testimony. We held several days of hearings on Edison's application in February and March 2000. The parties then filed opening and reply briefs, and additional evidence requested by the Administrative Law Judge ("ALJ") was submitted on July 6, 2000 and March 6, 2001.

On January 18, 2001, Assembly Bill X1 6 ("ABX1 6") (Stats. 2001-2002, 1st Ex. Sess., ch. 2) amended section 377 to require that utilities retain electric generation plant not yet divested, and prohibited the disposal of retained generation plant until January 1, 2006. Retained generation plant is subject to continued regulation by the Commission. A September 7, 2001 ruling by the assigned ALJ set aside submission of the proceeding and provided the parties an opportunity for comments and reply comments on the effects of the amendments to section 377. SCE, TURN and ORA filed comments.

On October 2, 2001, the Commission and SCE entered into a Settlement Agreement, and in accordance with the Settlement Agreement, SCE filed Advice Letter ("A.L.") 1586-E to establish the associated ratemaking structure and the Procurement Related Obligations Account ("PROACT"), which tracked the procurement-related obligations, plus interest. We issued Resolution E-3765 in January 2002, approving the structure and operation of the PROACT. In April 2002, we issued D.02-04-016, directing SCE to file an advice letter detailing its rate base consistent with the terms of the Settlement Agreement, and adopting revenue requirements and balancing accounts for the recovery of reasonable

costs.[2] In May 2002, SCE filed A.L. 1618-E, which modified the Settlement Rates Balancing Account. A.L. 1618-E also states that, in compliance with D.02-04-016, SCE has included the 1997 and 1998 capital additions in its recorded rate base in determination of both Utility Retained Generation and General Rate Case revenue requirements, and that the return on rate base and taxes calculated through December 31, 2001 on the 1997 and 1998 capital additions at issue in this proceeding are included in the NGCAMA. The amount in the NGCAMA related to return on rate base and taxes on 1997 and 1998 capital additions at issue in this proceeding as of January 2000 was approximately $1.5 million.

In September 2002, an ALJ Joint Ruling ("Joint Ruling") was issued in this proceeding and in A.02-05-004 requiring SCE to provide testimony on capital additions made in 1997 and 1998 for reliability and obsolescence projects. Attachment A to the Joint Ruling listed those projects to be removed from this proceeding and to be addressed in A.02-05-004. The total amount of reliability and obsolescence projects to be considered in A.02-05-004 was $30,937,000, and the capital additions to be considered in this proceeding amounted to $52,216,000. This proceeding was submitted in September 2002.

On February 19, 2004, we issued D.04-02-025 ("the Decision"). The Decision approved total capital additions costs of $52,216,000, and determined that these costs had already been recovered in rates or amortized by SCE. The Decision authorized SCE to recover in future rates the return on rate base and taxes on these capital additions because these costs had not yet been recovered by SCE in rates.

On March 22, 2004, TURN filed an application for rehearing of D.04-02-025. SCE filed a response to TURN's rehearing application on April 6, 2004.[3]

[2] These balancing accounts include: the Native Load Balancing Account; the Purchased Power Balancing Account; and the Independent System Operator Balancing Account. These accounts were established in A.L. 1614-E.

[3] In December 2004, we granted in full TURN's request for intervenor compensation, awarding TURN $103,741.20 as compensation for its contributions to D.04-02-025. (See D.04-12-010.)

III. DISCUSSION

In its rehearing application, TURN makes the following allegations of legal and/or factual error: 1) the Commission failed to put SCE to its proper evidentiary burden as to each project for which SCE sought cost recovery; 2) the Commission failed to make sufficient findings of fact and conclusions of law to support the Decision; 3) the Commission improperly permitted SCE to recover for capital additions that were not cost-effective or necessary to maintain the facilities through December 31, 2001; 4) the Commission erred by using SCE's proposed payback period for evaluation of the projects; and 5) the Commission improperly allowed SCE to recover costs related to two projects that SCE had withdrawn from its cost recovery request.

A. Sufficiency of Findings and Conclusions and Burden of Proof

In its rehearing application, TURN claims that the Decision violates Section 1705 because the Commission failed to make sufficient findings of fact and conclusions of law on all material issues raised in the proceeding. (Rehearing App., pp. 3-4.) TURN further asserts that SCE bears the burden of proving with clear and convincing evidence the eligibility of each project for cost recovery, and that SCE did not meet this burden with respect to those capital addition projects on which TURN challenged cost recovery. (Rehearing App., pp. 2-3.)

After reviewing the allegations of error raised in the rehearing application, we have determined that limited rehearing should be granted in order to provide the parties with an opportunity to develop the evidentiary record as to the capital additions projects challenged by TURN. We note that TURN's rehearing application also raises an issue as to what burden of proof SCE must meet for these particular capital additions. This issue will also be addressed during the limited rehearing proceeding. Specifically, the question is what burden of proof standard should be applied to SCE's capital additions.

B. Whether the Contested Capital Additions are Cost-Effective, Reasonable and Eligible for Cost-Recovery by SCE

TURN next alleges that the Commission erred in using SCE's proposed payback periods for evaluation of the projects instead of the shorter payback periods proposed by TURN and ORA. (Rehearing App., pp. 5-10.) TURN asserts that certain capital additions, while meeting the applicable cost-effectiveness criteria, nevertheless should not be approved for cost recovery by SCE because they were unreasonable. (Rehearing App., pp. 5, 10-16.) In its response to TURN's rehearing application, SCE argues that all of the projects contained in its application have benefits that exceed their costs, and in fact most have benefit-to-cost ratios indicating that the benefits substantially exceed the costs. (SCE Response, p. 5.) TURN's allegations of error as to these issues lack merit.

As noted in the Decision, SCE removed from its application any capital additions that had benefit-to-cost ratios of less than 1.0. (D.04-02-025, p. 13.) The Decision specifically cites to record evidence produced by SCE demonstrating that each project submitted in its application for cost recovery met this standard of cost-effectiveness. (See D.04-02-025, p. 13, fn. 16; see also Exhibit 1, Table III-15, p. 54 and Table III-18, p. 58; Exhibit 2, Table II-2, p. 30.) TURN's analysis of the cost-effectiveness of these projects differs because TURN proposes using shorter payback periods of seven to ten years in order to evaluate the cost-effectiveness of these projects. (Rehearing App., pp. 5-6.)

In analyzing which proposed payback period was appropriate, we noted that D.99-03-055 rejected similar shorter payback periods for 1996 capital additions, although D.99-03-055 did provide for consideration of shorter payback periods in other capital additions proceedings. (D.04-02-025, pp. 13-14.) However, in this proceeding we evaluated the evidence and arguments put forward by both TURN and SCE and concluded that the payback period advocated by SCE was appropriate under the circumstances. The Decision notes that initially these

capital additions projects were calculated using a twenty year payback period, but that beginning in May 1996, as a result of electric industry restructuring, SCE applied a ten year life to its fossil fired capital addition payback calculations. (D.04-02-025, p. 14.) The Decision concurs with SCE's contention that the application of a ten year payback period reflects the economic life of the capital additions, and that applying shorter payback periods would not be reasonable under the circumstances. (D.04-02-025, pp. 14-15.) Thus, we concluded that SCE's "capital additions to divested plants meet the standard of cost effectiveness adopted by D.9903-055, and therefore are reasonable." (D.04-02-025, p. 15.)

TURN clearly disagrees with our adoption of the payback periods proposed by SCE and our determination that the capital additions at issue in this proceeding were reasonable. However, our application of the statutes and regulations we are charged with implementing is entitled to a strong presumption of validity. (See *Greyhound Lines, Inc. v. Public Utilities Commission* (1968) 68 Cal.2d 406, 410.) In addition, as long as our determination is soundly based on the evidentiary record and inferences reasonably drawn from the record, such determination is considered to be supported by substantial evidence in light of the whole record, and it will not be reversed. (See, e.g., *Lorimore v. State Personnel Board* (1965) 232 Cal.App.2d 183, 187; *People v. Lane* (1956) 144 Cal.App.2d 87, 89.) Thus, our decision to adopt the payback periods proposed by SCE, and our determination that the capital additions were reasonable, is supported by the record and is within our proper discretion.

However, our discussion of the payback period issue inadvertently was not translated into findings of fact in the Decision. Accordingly, we modify the Decision to add findings of fact on this issue, in the manner set forth in the Ordering Paragraphs of today's decision.

C. The Commission's Evaluation of the "Necessary to Maintain" Standard

TURN next asserts that we erred in our evaluation of the "necessary to maintain" standard with respect to SCE's capital additions. (Rehearing App., p. 16.) According to TURN, we committed legal error because we failed to determine that the investments were necessary to maintain the system through 2001 and were otherwise reasonable. (Rehearing App., pp. 16-19.)

After reviewing the allegations of error raised by TURN, we have determined that limited rehearing should be granted in order to provide further factual development as to whether the following six capital additions projects were reasonable and "necessary to maintain" the facilities within the meaning of section 367: 1) Ormond Beach (Work Orders 1727-0554, 1727-0555); 2) Etiwanda Control Room Integration (Work Order 1316-7711); 3) Mandalay Economizer (Work Order 1712-0535); 4) Mandalay Pipeline (Work Order 3275-0323); 5) El Segundo Controls (Work Order 1516-0833); and 6) Coolwater Spare Parts (Work Orders 9000-1031, 3393-0044).

D. Recovery of Costs Allegedly Related to Unreasonable Projects from Plant Sale Proceeds

Finally, TURN asserts that the Commission improperly allowed SCE cost recovery related to two projects[4] that Edison withdrew from its cost recovery request. (Rehearing App., p. 19.) TURN claims that SCE voluntarily withdrew these projects from its cost recovery request because they failed to meet the cost-effectiveness threshold, but that the Commission nevertheless approved recovery of these costs in D.04-02-025. (Rehearing App., pp. 19-21.) In response, SCE agrees that it withdrew the two projects "because they did not meet the cost-effectiveness threshold utilizing Commission-adopted assumptions of D.99-03-055." (SCE Response, p. 8.) However, SCE asserts that this does not mean that

[4] The two projects TURN refers to are Work Orders 1413-0402 (Alamitos Units 3 & 4 Reconductor) and 3390-0440 (Cool Water Units 3 & 4 Transition). (See Rehearing App., pp. 19-20, fn. 58.; see also D.04-02-025, p. 14, fn. 23.)

the projects were unreasonable, just that they were not eligible for recovery under the Commission's precedent. (SCE Response, pp. 8-9.)

After reviewing the arguments of the parties, we have determined that limited rehearing should be granted in order to clarify whether these two projects were approved for cost recovery, and if so, to provide an opportunity for the parties to further develop the record as to whether these projects were reasonable and eligible for cost recovery by SCE.

IV. CONCLUSION

Limited rehearing is granted as described above. As to all other issues, rehearing of D.04-02-025 is hereby denied.

IT IS THEREFORE ORDERED THAT:

1. Limited rehearing of D.04-02-025 is granted in order to: a) provide further factual development as to certain contested capital additions projects and supplement the Decision's findings of fact and conclusions of law; b) clarify the issue of what burden of proof standard should apply to SCE's capital additions; c) address whether six contested capital additions meet the "necessary to maintain" standard; and d) determine whether cost recovery was improperly permitted for two capital additions projects that allegedly were not cost-effective.

2. SCE is permitted to continue to recover in rates all amounts authorized for recovery in D.04-02-025 that are not yet fully recovered, subject to adjustment and/or refund, pending the outcome of the limited rehearing.

3. D.04-02-025 shall be modified to add the following finding of fact as Finding of Fact No. 8:

> The 10-year payback period proposed by SCE is reasonable in terms of accurately reflecting both the economic life of the capital additions projects at issue and the information reasonably available to SCE at the time it made the decision to go forward with its capital additions. Applying shorter payback periods would not be reasonable under these circumstances.

4. Rehearing of the Decision, as modified, is denied in all other respects.

This order is effective today.

Dated June 15, 2006, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners